

SUPERIOR COURT OF THE STATE OF CALIFORNIA
County of San Luis Obispo

DATE: July 22, 2010

DEPARTMENT NO. 9

PRESENT: HON. CHARLES S. CRANDALL, JUDGE

L. Tetley, DEPUTY CLERK

A. Maez, BAILIFF

Cassie Frasher, REPORTER

TITLE	COUNSEL
STINCHFIELD FINANCIAL ,	<u>Jane Heath</u>
PLAINTIFF(S)	
VS.	
STEWART INFORMATION SERVICES,	<u>James Buttery</u>
DEFENDANT(S)	<u>Samuel R. Miller</u>
	<u>Samuel D. Ellis</u>

ACTION NO.: CV 098107

PROCEEDINGS: RULING ON DEMURRERS AND MOTION TO STRIKE

Stinchfield Financial Loan Services ("Stinchfield") files its Second Amended Complaint ("Second Complaint") on behalf of a number of individual investors who, through Stinchfield the broker, loaned approximately \$3,000,000.00 to developer Kelly Gearhart/Graves Creek. The loan was secured by a number of lots in a 60 unit senior condominium development.

Plaintiff's core allegation is that Stinchfield and the individual lenders were unaware that a large percentage of the lots used as security for the loan were subject to a restriction that they could only be used for "low" or "very low" income housing. As a result of the restrictions on the sale of those lots, the appraisal was inaccurate and the lenders were ultimately left undersecured.

The developer/borrower defaulted on the loan. Stinchfield has foreclosed on the unrestricted lots but, for various reasons, has not foreclosed on the lots with low income restrictions. In any event, the value of the restricted lots is quite low given the restrictions on sale to low or very low income buyers.

Stinchfield names as defendants Cuesta Title Company, who served as the escrow agent, and Stewart Title Guaranty (and subsidiaries Stewart Title Company and Stewart Title of California, Inc.), which issued the policy of title insurance. Stewart Information Services, Stewart Title Guarantee, its subsidiaries, and Cuesta Title demur to the Second Amended Complaint.

The Stewart Demurrers

With respect to the first cause of action, Stewart Information Services, Stewart Title Guaranty, and its subsidiaries, contend that they are not parties to the escrow agreement, and that only Cuesta Title served as the escrow agent. This issue has been addressed by the Court in previous demurrers.

Briefly, an escrow agent's agency and fiduciary obligations to the parties are set by the express provisions of the escrow instructions. *Summit Financial Holdings, Ltd. v. Continental Lawyers Title Co.* (2002) 27 Cal.4th 705, 711; *Romo v. Stewart Title of California* (1995) 35 Cal.App.4th 1609, 1618 at Fn. 9. Absent clear evidence of fraud, an escrow holder's relationship with the parties to the escrow is limited to complying strictly with the parties' instructions. See Greenwald, et al., *Real Property* (Rutter Group 2009) §4:581. The question presented here, however, is who really was the escrow agent.

Although paragraph 43 is not a properly pled allegation of material fact that must accepted as true for the purposes of demurrer (*See Weil & Brown, Civil Procedure Before Trial* (Rutter Group 2009) §7:43), at oral argument plaintiff emphasized that one of the central figures in the transaction, a nominal Cuesta employee, actually received her paychecks from "Stewart Title." This raises a factual question as to whether Stewart Title Guarantee, and/or Stewart Title Company, and/or Stewart Title of California Inc. were "involved" in the escrow transaction.

The demurrer to the first cause of action as to Stewart Information Services is sustained without leave to amend because it was not itself a party to the escrow agreement. The demurrers of Stewart Title Guarantee, Stewart Title Company, and Stewart Title of California Inc. are overruled. Further, assuming that plaintiffs comply with the additional instructions below, they may still maintain allegations of alter ego with respect to Stewart Title Guarantee, Stewart Title Company, and Stewart Title of California Inc.

With respect to the second third and fourth causes of action, Stewart Title Guaranty appears to be the defendant that issued the title insurance policy. The demurrer of the *subsidiaries* of Stewart Title Guaranty Company to the second, third and fourth causes of action is based upon the contention that the subsidiaries are not parties to the escrow agreement or the title policy. The demurrer of the Stewart Title defendants (other than Stewart Title Guaranty Company) to the second, third and fourth causes of action is sustained without leave to amend.

With respect to the fifth cause of action for fraud, the basis of the demurrer is lack of specificity, which has already been addressed by the Court in previous demurrers.

The allegations in connection with the fraud cause of action allege that there was a failure to *clearly identify* the existence of the low income housing restrictions. See, e.g., ¶ 24 and 25 (failure to disclose the Development Restriction or DR agreements in greater detail); ¶26 (deed restrictions not included in the conveyances served to mislead); ¶28 (failure to adequately disclose the restrictions on transfer); ¶63 (alleging defendants' concealment from plaintiffs and use of false escrow information); ¶64 (reliance).

Although the preliminary title report references the existence of the limitation at Section 26 of the Report, plaintiff alleges that the disclosure was not sufficiently detailed and, as a result, constituted fraud. In other words, plaintiff is alleging that the low income housing restriction was camouflaged by its placement and minimization in the title documents.

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While not a model of pleading clarity, there is sufficient specificity of Stewart Title Guaranty Company's knowledge of alleged improprieties and involvement in suppression of material facts to establish potential liability. *Compare Citizens of Humanity, LLC v. Costco Wholesale Corp.* (2009) 171 Cal. App. 4th 1, 20-21 (vague allegations insufficient for court to weed out nonmeritorious claims). Moreover, the duty to plead fraud allegations with specificity is somewhat relaxed where, as here, the facts lie more in the knowledge of the opposite party. *Committee on Children's Television, Inc. v. General Foods Co.* (1983) 35 Cal 3rd 197, 217; *compare Citizens of Humanity* 171 Cal. App. 4th at 20-21 (facts of fraudulent scheme held to be within ready knowledge of the plaintiff).

The demurrers of Stewart Title Guarantee, Stewart Title Company, and Stewart Title of California Inc. to the fifth cause of action are overruled. Further, assuming that plaintiffs comply with the additional instructions below, they may still maintain allegations of alter ego with respect to Stewart Title Guarantee, Stewart Title Company, and Stewart Title of California Inc.

The negligence cause of action alleges that the deed restrictions were not clearly delineated on the policy of the title report. An insured's claim against his title insurer is under the policy, and an insured has no separate claim against a title insurer based on negligence or negligent misrepresentation. *Vournas v. Fid. Nat. Title Ins. Co.*, (1999) 73 Cal. App. 4th 668, 675-676. The rule with respect to issuance of a preliminary title report is the same. *Rosen v. Nations Title Ins. Co.* (1997) 56 Cal. App. 4th 1489, 1499-1500.

The negligence claim directed at Stewart Title defendants is sustained without leave to amend.

The tenth cause of action regarding unlawful business practices against Stewart is premised on "suppressing and misrepresenting the Deed Restriction Agreements" and "perpetrating fraud through...title reports by intentionally omitting information regarding Unit sales price limitations." (§91)

Again, the tenth cause of action is not a model of clarity. However, there is sufficient specificity to overcome a demurrer on the basis of Stewart Title Guaranty Company's knowledge of alleged improprieties in various transactions and its intentional suppression or material information. Likewise, there are sufficient allegations of its participation in the transactions to establish potential liability. As stated, specific pleading standards are relaxed where the facts lie more in the knowledge of the opposite party. *Committee on Children's Television, Inc. V General Foods Co.* (1983) 35 Cal 3rd 197, 217. The demurrer to the tenth cause of action is overruled.

With respect to the eleventh cause of action for conversion, the involvement of the Stewart defendants in the transfer of the HOA funds is not detailed. The demurrer is sustained with leave to amend the complaint and allege facts of demurring defendant's role in the conversion.

Plaintiffs concede that the assignors are not entitled to punitive damages. The motion to strike the punitive damage allegations is granted.

Cuesta Title Demurrer

The general duties and liabilities of an escrow agent are described in *Summit Financial Holdings, Ltd. v. Continental Lawyers Title Co.* (2002) 27 Cal.4th 705, 711 and *Romo v. Stewart Title of California* (1995) 35 Cal.App.4th 1609, 1618 at Fn. 9.

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The elements of a breach of contract cause of action require allegations that the defendant failed to do something that the contract required, and that plaintiff was harmed by that failure. *See* CACI 300 and 302. Although the complaint alleges a breach of contract for Escrow Services, it does not allege any specific escrow instruction that was breached by Cuesta. Rather, the allegations allege generally that Cuesta failed to satisfy the express and implied terms of its contract, failed to obtain beneficiary consent for a tract map, and accepted a signature on the Tract Map that was known to be unauthorized. There is no indication that this activity was in conjunction with the escrow services provided by Cuesta.

Plaintiffs contend that they need to conduct discovery to ascertain the nature of the breach. However, it is incumbent upon plaintiff to have some supporting evidence before its complaint is filed. Because the general allegations do not identify the obligations that were breached by Cuesta, the demurrer is sustained with leave to amend.

With respect to the second cause of action for breach of contract for title services, Stewart Title Guaranty appears to have issued the title policy, and it is the party which undertakes the duties and obligations under the policy. Plaintiff does not cite any authority supporting the conclusion that a party who “countersigns” a policy is the issuer with the duties of an insurer. The demurrer is sustained without leave to amend.

To the extent that the covenant of good faith and fair dealing cause of action arises out of the insurance agreement, the demurrer is sustained without leave to amend. To the extent that it arises out of the escrow agreement, the demurrer is sustained with leave to amend.

Cuesta Title did not demur to the fourth cause of action for declaratory relief.

With respect to the negligence cause of action, an escrow agent’s agency and fiduciary obligations to the parties are set by the express provisions of the escrow instructions. An escrow holder's relationship with the parties to the escrow is typically limited to complying strictly with the parties' instructions. *See* Greenwald, et al., *Real Property* (Rutter Group 2009) §4:581. However, an escrow agent can be negligent in the performance of duties *Id.* §3:4.2

Although the complaint generally alleges negligence by Cuesta, it does not allege how Cuesta may have negligently breached its escrow obligations. The demurrer is sustained with leave to amend.

With respect to the fraud claim, plaintiff asserts that Cuesta wrongfully failed to disclose that the lots serving as security were subject to low and very low income requirements. As previously stated, the general duties and liabilities of an escrow agent are described in *Summit Financial Holdings, Ltd. v. Continental Lawyers Title Co.* (2002) 27 Cal.4th 705, 711 and *Romo v. Stewart Title of California* (1995) 35 Cal.App.4th 1609, 1618 at Fn. 9.

Plaintiffs allege not only that named employees of Cuesta Title acted outside their typical role of an escrow agent, but also that these employees of Cuesta: 1) handled the DRE agreements for the developers, knew these submittals well, and failed to disclose the full extent of the DRE limitations; 2) were fully aware that a large percentage of the lots used as security for the loan were subject to “low” or “very low” income housing restrictions, but concealed these facts, leaving the lenders undersecured; 3) inappropriately closed escrow without bonds and without notices of completion; and, 4) released HOA fees in violation of explicit escrow requirements.

Once again, while not a model of pleading clarity, there is sufficient specificity of Cuesta's knowledge of alleged improprieties and involvement in suppression of material facts to establish potential liability. *Compare Citizens of Humanity, LLC v. Costco Wholesale Corp.* (2009) 171 Cal. App. 4th 1, 20-21 (vague allegations insufficient for court to weed out nonmeritorious claims). Moreover, the duty to plead fraud allegations with specificity is somewhat relaxed where, as here, the facts lie more in the knowledge of the opposite party. *Committee on Children's Television, Inc. v. General Foods Co.* (1983) 35 Cal 3rd 197, 217; *compare Citizens of Humanity* 171 Cal. App. 4th at 20-21 (facts of fraudulent scheme held to be within ready knowledge of the plaintiff). The demurrer to the cause of action for fraud is overruled.

With respect to unlawful business practices against Cuesta, the demurrer is overruled for the same reasons expressed with respect to Stewart Title.

The cause of action for conversion alleges that Cuesta assisted in the conversion of HOA funds held in an account by releasing them without a proper basis. Paragraph 31 of the complaint specifically alleges that the escrow company knew that the facts justifying the release of funds were false and that Don Price was not authorized to take possession of the funds. The demurrer to the conversion cause of action is overruled.

The alter ego and conspiracy allegations are not truly causes of action but do set forth potential liability of related entities. While these allegations in the Second Complaint treat Stewart Title Guarantee, Stewart Title Company, and Stewart Title of California Inc. and Cuesta Title as a single, related defendant, such allegations are insufficient for pleading purposes. Plaintiff must separately plead an alter ego allegation as to each remaining cause of action, as well as a separate conspiracy allegation if one is to be alleged. These alter ego pleadings should discuss whether Stewart Title Guarantee, Stewart Title Company, and Stewart Title of California Inc. were directly "involved" in the escrow transaction by virtue of their payroll responsibility to the Cuesta employee. The demurrer on this basis is sustained with leave to amend.

The demurrer to the first cause of action as to Stewart Information Services is sustained without leave to amend because it was not itself a party to the escrow agreement. The demurrers of Stewart Title Guarantee, Stewart Title Company, and Stewart Title of California Inc. are overruled. Further, assuming that plaintiffs comply with the additional instructions below, they may still maintain allegations of alter ego with respect to Stewart Title Guarantee, Stewart Title Company, and Stewart Title of California Inc.

Counsel is commended for their focused argument. However, if a Third Amended Complaint is to be filed, plaintiffs should eliminate unnecessary verbiage, state the additional claims succinctly, separate out the bases of liability, and simplify the issues to the extent possible. Counsel for plaintiff shall provide notice of this ruling.

Date: July 22, 2010

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Judge of the Superior Court